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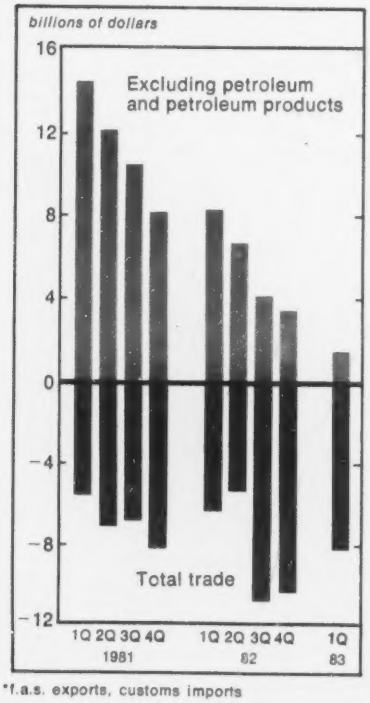
A Glimmer of Hope For U.S. Exports

U.S. trade data over the next few months are likely to confirm the widely held view that recovery abroad is lagging behind that of the United States. As the American economy gathers steam, imports will surge. The increase in U.S. exports, however, will be considerably smaller, primarily because America's major trading partners—Canada excepted—will grow at a markedly slower rate than the United States over the next few quarters.

There is general agreement among economists that U.S. net exports are on a declining trend at least until early 1984; however, there is a considerable divergence of opinion over how far they will fall. Many forecasters are calling for a trade deficit in the neighborhood of $45 billion (census basis) for 1983—$13 billion more than last year's number. But projections of a somewhat narrower ($40 billion), or significantly wider ($50-55 billion), deficit easily can be defended.

The U.S. trade balance,* including and excluding oil



*f.a.s. exports, customs imports

While a deterioration in the U.S. trade account is certain to make headlines, the more significant development is that weak export demand will not brake the momentum of the U.S. economy nearly as strongly this year as it did in 1982. Although exports to the OPEC countries are falling, there is a good chance that the trough in demand for U.S. exports by the non-oil developing countries was reached late last year. And with Canadian markets likely to recover significantly, the volume of U.S. exports to the industrialized countries should be somewhat higher by the end of this year than it was at the end of 1982.

The current outlook for a stable-to-slightly-growing level of U.S. exports (adjusted for inflation) is in sharp contrast to the experience of last year, when exports of goods and services fell a staggering 12% (fourth quarter over fourth quarter). The 1982 deterioration is partly explained by the persistent strength of the dollar. However, the timing of the decline suggests that a much more important explanation for the United States' disastrous export performance last year was the abruptly worsened growth of its trading partners in the second half of the year: Debt-service difficulties forced Latin America to cut back imports drastically, and the recession in Canada and Western Europe suddenly intensified.

The strong dollar will continue to hamper U.S. exports and encourage imports. But the primary determinant of the U.S. trade balance will remain the relative economic performance of the United States and its key trading partners.

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France may be on verge of recession; reduction in trade deficit seen.

Recently released provisional figures show that France's real GDP in the first quarter expanded at a annual rate of 1.6%. However, this was entirely the result of inventory accumulation, much of which was probably unintended. More recent data show the first effects of the March austerity measures: Industrial orders fell sharply in April and May while stocks rose further, suggesting that the economy is on the verge of a recession. Real GDP for 1983 as a whole is expected to decline by some 0.4%, which would mean an even larger fourth-quarter-to-fourth-quarter decline. This, together with recoveries in the United States and most European countries, would result in a significant improvement in the French trade deficit. The official aim is to halve the deficit to a level of 45 billion francs by May 1984. If Germany's economic recovery gathers steam and the dollar comes off its current highs, France may do even better.

Norway weathers oil-price decline surprisingly well.

The performance of the Norwegian economy has turned out better than had been expected, given the drop in oil prices. Despite lower oil revenues, the balance of trade has so far shown a larger surplus this year than last. Official figures for the current-account balance show a surplus of 2.2 billion kroner in the first two months of 1983, compared with 1.6 billion in the first two months of 1982. The non-oil sectors of the economy are also showing some strength, so that GDP will remain virtually flat in 1983 after its 1.4% fall in 1982. Inflation, too, is on an improving path. The consumer price index is now rising very slowly, and the year-on-year inflation rate has dropped to 9.1% from 11.3% at the end of last year. Wholesale prices have so far been steady this year, with the most recent year-on-year increase down to 5.7%. Thus, although higher oil prices would have increased the value of Norway's huge oil reserves, the economy is sufficiently diversified to absorb a high degree of fluctuation without undue difficulty.

Mexican private sector hard hit by country's financial crisis.

A major victim of Mexico's financial crisis is the private sector, in large part because of the scarcity of foreign exchange. Private-sector imports will fall again this year—down to approximately $7 billion from $9 billion last year and $15 billion in 1981. In addition, although reactivation of the private sector is one of the announced medium-term goals of the current administration, the government appears to have reduced the priority of servicing the private-sector's foreign debt; some arrears have developed on private-sector interest payments. While current conditions are forcing all sectors of the economy to take belt-tightening measures, to ask the private sector to do more than its share will delay its recovery.

China's imports growing after surge in capital spending last year.

On the strength of an excellent harvest and a significant recovery in heavy industry, China's economic growth rose to an annual rate of 7.4% last year from 3% in 1981. Signs of reflation were most evident in capital construction where the volume of activity grew 25% in 1982 after an 18% slump in the previous year. This increase was due in large part to above-plan expenditures by local governments and individual enterprises, spurred by a relaxation of financial restraint. Only half of 1982's total investment was covered by funds in the state budget; the rest was financed by local budgets and domestic loans. Despite domestic reflation, the Bank of China maintained its strict regulation of convertible currency, and China's imports were unchanged in volume terms in 1982. Continuing growth in export volume—up 6.5%—pushed the trade surplus to $4.5 billion from $1.7 billion in 1981. With foreign-exchange reserves in excess of $11 billion at the end of 1982, China announced that it will repay ahead of schedule the funds borrowed from the IMF two years ago. As a result of the turnaround in capital spending, imports of steel and machinery appear to be on the rise. Thus far, 1983 has shown a clear pickup in Chinese contracts for Western goods. The trade balance is expected to move toward a modest deficit in the second half of the year and early in 1984.

Modest turnaround expected for the Argentine economy.

Argentina's economy continues to improve, paced by rising agricultural exports and the stimulation of import-substitution output. Real GDP, in the first quarter of 1983 rose almost 1% from its year-earlier level. A rapid rate of currency devaluation and quantitative restrictions have deterred import growth. Consequently, import substitution of goods such as machinery, equipment, paper, and textiles led to an over-5% increase in industrial production in the first quarter. The rising level of activity has been accompanied by high inflation, but monthly price trends have shown a decline, thanks to restrictive monetary and fiscal policies: wholesale prices fell from a 14.7% monthly rate in January to 6.8% in April, and consumer prices dropped from 16% to 10% over the same period. In an important test of the country's stabilization policies, a first-quarter review showed that the government met the IMF's performance criteria. With a foreign trade surplus assurred for the year, a continuation of domestic policies aimed at careful reactivation should result in an at least a 3% real GDP rise for 1983. This would be a dramatic improvement from the big output declines of almost 6% per annum in the previous two years.

Sri Lanka's near-term outlook improves, but longer-term problems loom.

The immediate prospects for the Sri Lankan economy have improved somewhat, thanks to early elections, government budget measures, the recovery in commodity prices, and the sharp drop in petroleum prices. Real economic growth of somewhat over 5% is expected in 1983, about the same as the 5.1% growth recorded in 1982. In addition, the current-account deficit is expected to narrow to $450 million—8.5% of GDP—from $568 million last year, some 11.8% of GDP. Export revenues are projected to increase just over 7% owing to the rebound in prices for Sri Lanka's traditional tree-crop exports, while a sharp drop in the oil import bill will keep import outlays roughly flat. Inflation, however, is expected to accelerate to an average of about 15% in 1983, up from 10.8% last year. Moreover, the Jayewardene government faces a number of longer-term problems—including sluggish tree-crop and manufacturing production, stagnant exports, and excessive reliance on foreign savings—which it must tackle during its second term if the economy is to perform satisfactorily in the future.

In Turkey, growth of imports outpacing exports.

Foreign trade developments in the first quarter of 1983 have been causing Turkish policymakers some concern. January-March imports showed a provisional year-on-year rise of some 17.6%, while exports grew by only 4.2%. As a result, the trade deficit widened to $945 million, from $656 million in the first quarter of 1982. Furthermore, workers remittances—an important source of foreign exchange for the economy—have been running below year-earlier levels in the first two months of 1983. A combination of fairly buoyant domestic demand, reduced exports to the Middle East, and the poor employment picture in Germany appear responsible for this setback. Policymakers are hoping, however, that the upswing in Europe will strengthen and that import growth, which has been erratic on a monthly basis, will abate somewhat.

Despite shrinking, reserves, Yemen's import spending continues to rise.

The Yemen Arab Republic, one of the poorest countries in the Middle East, experienced a further deterioration in its external position in 1982 despite an increase in receipts from its major sources of foreign exchange. Remittances from Yemenis working abroad, mainly in Saudi Arabia, grew by 20.9% to $1.18 billion, while aid grants increased from $332 million in 1981 to $439 million. At the same time, however, import spending continued to grow on the back of expansionary fiscal policies, up 13.4% to $1,965 million. Also, remittances from foreigners working in Yemen almost doubled to a level of $362 million. The result was a current-account deficit of $690 million—some 20% of GNP and $42 million higher than in 1981. Although the authorities were successful in mobilizing increasing volumes of concessional aid financing, they were unable to prevent reserves from falling by some $350 million during the year. This decline has continued into 1983. As of April, official reserves totaled $428 million, the equivalent of 2.6 months of the 1982 import bill.

Corporate Balance Sheets Looking Better

The recovery has brought with it a substantial improvement in business balance sheets. Corporate liquidity is clearly on the rise, and debt/equity ratios are falling for the first time in six years. Both of these developments potentially bode well for the second stage of a typical recovery—the investment boom. However, it may well be premature to look for a large upswing in investment anytime soon.

The fall in debt/equity ratios is one of the more important of the emerging improvements in corporate balance sheets. Since the beginning of the year, gross proceeds from new common stock issues have totaled about $21 billion, or almost double the total for the first half of 1981. At present, this pace seems likely to continue for at least some weeks to come. And if it holds for the remainder of the year, the proportion of net funds raised from new equity issues to total funds raised externally by nonfinancial corporations will reach a record 35%. This, combined with an almost-certain large jump in retained earnings this year, will provide a boost to stockholders' equity well in excess of the rise in total debt, giving the corporate sector a much-needed infusion of capital.

Corporate liquidity positions are also noticeably healthier. Throughout the last nine months, firms have taken advantage of favorable market conditions to raise funds in both the stock and the bond markets to pay off short-term debt. Business cash flow has also been bolstered by the drop in corporate tax payments and the surge in corporate tax refunds this year. In fact, 1983 refunds have been running about 75% higher than last year. At the same time, inventories have been run down at a record pace, and firms have made marked additions to their holdings of liquid assets. Since the end of the third quarter of last year, nonfinancial firms' holdings of liquid assets have gone up by an estimated $25-30 billion, compared with a rise of only $5 billion over roughly the same period a year ago. The net result has been a dramatic improvement in the corporate-liquidity measure known as the "quick ratio," or the ratio of liquid assets to current liabilities.

Of course, this improvement does not necessarily mean that corporate balance sheets are in great shape, since they are recovering from recession-battered levels. Still, from a liquidity standpoint, businesses now seem at least able to begin adding to investment—a prerequisite for a sustainable recovery. However, they may not be ready to do so just yet. Factory operating rates are still distressingly low, and there remains widespread concern that the recovery is somewhat fragile. But at least, prospects are looking up.

Thomas A. Lawler

Wage, Productivity Trends Aiding Disinflation

Above-target money growth since last August has raised concerns about a renewed acceleration of inflation. While such concerns may, at a later date, prove to have been justified, the near-term outlook for inflation is quite favorable. Among the forces contributing to that outlook are conditions in the labor market, specifically the prospects for wages, productivity, and unemployment.

Average wage and benefit gains have been slowing for about two years now—from a peak of over 10% in early 1981 to less than 6% currently. Average wage settlements for large collective-bargaining agreements have improved even more dramatically, with the first quarter actually showing compensation *declines* for the first year of multiyear contracts.

High unemployment, of course, has contributed to this moderation. A beneficial side effect of the jobless rate lingering above 10% has been a continuing increase in productivity. Output per man-hour usually rises toward the end of a recession as layoffs cause the decline in the number of hours worked to exceed the drop in output, and the 1981-82 recession was no different. However, the productivity gain of nearly 5% at an annual rate recorded during the first quarter of this recovery is unusually strong—especially in light of the near-zero trend of the past five years.

Higher productivity and lower wage gains combined to sharply reduce the cost of labor per unit of output, allowing corporate profitability to go up without adding much upward pressure on prices. For example, operating profits surged 60% at a annual rate during the first quarter, while a broad price index rose only 3%; unit labor costs increased only slightly over 1%.

This decline in the relative price of labor has helped to increase labor demand. Payroll employment has risen by more than 1 million since December 1982, enabling the unemployment rate to fall from its peak of 10.8% last November to 10.1% in May.

Although unemployment is edging down, it is still high and will continue to exert some downward pressure on wages. In addition, output gains are likely to continue to outstrip the growth in employment, so rising productivity will keep any unit-labor-cost increase small and allow further gains in profitability without any stepped-up pressure on prices. Moreover, falling unemployment gives the Federal Reserve some more room to rein in rapid money growth.

The only sticking point in the labor-market outlook is the possibility of a rise in the unemployment rate over the summer if the labor force—which has actually been shrinking since December—starts to grow. This might dampen wage gains even more in the short run, but could induce the Fed to continue easing. That would eventually lead to a turnaround in inflation expectations, wage growth, and prices.

Douglas L. Bendt

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GDP IN 1982		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
		6 months ending	change from year earlier	in billions of dollars	$ per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	12-month changes: latest data	12-month changes: consumer prices	latest data	money supply(M1)	exchange rate in U.S. dollars June 15, 1983	change from year earlier	current monetary conditions	
Argentina	Real GDP increased by almost 1% in first quarter, led by industry and agriculture.	Dec.	—37%	130.0	4,594	Feb.	3,859	+ 11%	9.3	888	IMF targets met in March.	Mar.	+304%	Nov.	+242%	.1052*	—85%	New Argentine peso denominated.	Argentina
Brazil	Increases in taxes, cuts in subsidies and spending form part of renewed austerity plan.	Dec.	—17%	293.0	2,382	Dec.	3,928	— 41%	2.3	1,449	IMF targets missed in March.	Feb.	+106%	Dec.	+ 72%	.00215	—69%	Attempt made to lower interest rates.	Brazil
Chile	Economic activity continues to deteriorate.	Jan.	— 8%	23.7	2,060	Apr.	1,225	— 56%	5.1	451	Current account posted $120-billion surplus in first quarter.	Mar.	+ 25%	Nov.	— 8%	.0136	—45%	Nominal interest rates declining.	Chile
Colombia	Real activity adversely affected by decline of domestic and foreign markets.	Oct.	+ 9%	39.0	1,423	Apr.	2,980	— 31%	6.4	0	Reserves have declined $827 million since end-1982.	Mar.	+ 22%	June	+ 24%	.0131	—22%	Bank legal lending limits proposed.	Colombia
Costa Rica	Confidence increasing in government's economic policy.	Feb.	—14%	2.8	1,164	Apr.	284	+ 97%	4.0	105	Higher prices on agricultural exports will help trade balances.	Dec.	+ 82%	Nov.'81	+ 70%	.0290	+ 5%	Credit still restricted.	Costa Rica
Dominican Rep.	Growth to be constrained by IMF-supported austerity program and lack of private investment.	Nov.	—37%	8.2	1,464	Apr.	173	— 7%	1.3	194	Falconbridge expects to produce half of last year's mineral output.	Oct.	+ 8%	Jan.	+ 8%	Par	—	Liquidity is tight.	Dominican Rep.
Ecuador	Slowdown in economy prompted by stabilization program and weather problems.	Nov.	—20%	14.0	1,573	Apr.	244	— 61%	1.7	0	Oil export earnings offset non-oil export decline.	Feb.	+ 29%	Oct.	+ 21%	.0124	—54%	Monetary policy is restrictive.	Ecuador
El Salvador	Economy deteriorating because of civil war.	Dec.	—23%	3.6	729	Apr.	100	+ 4%	1.3	105	Destructive war reducing export output.	Jan.	+ 13%	Jan.	0	.4000	0	Credit policy loose to reactivate economy.	El Salvador
Guatemala	Private sector confused by president's attitude.	Jan.	+22%	8.4	1,090	Apr.	65	— 66%	0.6	103	Improvements in sugar and small oil exports.	Feb.	— 1%	Feb.	— 6%	Par	—	Credit restricted to build up reserves.	Guatemala
Honduras	Political turmoil leading to reductions in private investment.	Oct.	—22%	2.8	718	Apr.	113	+ 8%	2.1	118	Better prices but low volume of agricultural exports expected.	Dec.	+ 10%	Nov.	+ 3%	.5000	0	IMF's tight credit guidelines still being followed.	Honduras
Jamaica	March IMF performance targets were not met.	Dec.	—27%	3.1	1,378	Mar.	96	— 29%	0.8	599	United States will double purchases of Jamaican bauxite this year.	Dec.	+ 7%	Feb.	+ 6%	.5600	— 2%	Credit policy is restrictive.	Jamaica
Mexico	Government complying fully with IMF stabilization program.	Jan.	+27%	207.0	2,248	Sept.	1,153	— 59%	1.7	326	Large trade surplus recorded in first quarter.	Mar.	+115%	Dec.	+ 66%	.00664	—68%	Domestic credit policy is tight.	Mexico
Nicaragua	Another debt rescheduling sought for both interest and principal.	Aug. '81	+27%	2.7	930	Nov. '79	85	+ 42%	1.1	19	Exports affected by guerrilla war.	July '81	+ 28%	Dec.	+ 26%	.1000	+ 1%	Domestic credit increasing rapidly.	Nicaragua
Panama	Government fiscal program is more restrictive to cut borrowing needs.	Dec.	+64%	4.0	2,020	Mar.	64	— 42%	0.5	81	New IMF program being approved.	Feb.	+ 2%	Dec.	+ 5%	Par	—	Credit growth is moderate.	Panama
Paraguay	Floods interfering with normal import-export activity.	Feb.	—41%	5.7	1,691	Apr.	696	— 13%	12.0	0	Lower capital inflows depress reserves.	Dec.	+ 4%	Aug.	— 4%	.00625	—21%	Money growth shows sharp decline.	Paraguay
Peru	Price of petroleum (currently $1.10 per gallon) being raised to maintain present dollar price.	Dec.	+ 1%	19.8	1,053	Jan.	1,156	0	4.1	612	Liquid reserves fell to $550 million at end-March from $1 billion end-1982.	Feb.	+ 85%	Dec.	+ 35%	.00069	—55%	Net foreign assets declining.	Peru
Uruguay	Industrial production declined 17% in 1982.	Dec.	— 5%	9.4	3,240	Feb.	58	— 76%	0.8	82	Oil imports down sharply: Feb. total was $48mn. vs. $103mn. year earlier.	Jan.	+ 38%	Dec.	+ 20%	.0103	—88%	Credit expansion restricted.	Uruguay
Venezuela	Import shortages and payments delays depress business activity.	Dec.	— 1%	73.0	4,066	Apr.	5,559	— 25%	5.4	0	IMF export-shortfall facility being sought.	Feb.	+ 6%	Jan.	+ 7%	.0980	—58%	Discount rate cut to stimulate credit.	Venezuela

*in terms of new Argentine peso

World Interest Rates

market rates as of June 15, 1983; bond yields as of June 10, 1983

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	8.50	9.53	n. a. intervention rate	9.50	9.50	4.00	17.00 penalty rate 20.00	4.50	4.00	5.50
Day-to-Day Money	9.00 June 16	9.00	9.50	9.50	12.375	5.00	17.75	5.25	3.375 1-month Euro-Swiss fr. rate	6.25
Treasury Bills 91-day, Middle Rates	8.70	9.22	9.438	9.75	n. a.	n. a.	15.899 71 days	no dealing	no market	5.375
Commercial Paper prime, 3-month, asked	9.125 finance paper discount basis	9.30 finance paper 15% tax w/h	n. a.	9.40 Certified	12.688 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	9.10	9.25 15% tax w/h	9.359	9.40 Certified	not traded	5.00	18.55	no market	5.25	no market
Government Bonds Long-term, new and old issues, average yield	11.03	11.70	n. a.	10.19	13.65	8.02	18.36	9.40	4.57	7.231
Industrial Bonds prime, long-term, new and old issues, average yield	11.75 Aa Industrials	12.20	n. a.	11.82	14.80	8.02	17.95	9.36	5.90	6.47
Bank Short-Term Rate (prime rate)	10.50	11.50	10.00	13.25	14.55	8.00	18.75 ⅛ qtrly fee on outstdng.	8.00	7.50	6.00
Bank Time Deposits 3-month	9.10 Cert. of Dep.	9.30	9.75	9.65	12.75	5.55	11.50	6.125 large deposits	4.00 residents only	3.75 20% tax w/h
Eurocurrencies 3-month, asked	9.8125	9.563	9.875	no market	14.875	5.375	no market	5.813	5.188	6.50
Exchange Rates—in U.S.$ rates floating against the $	—	.8089	1.513	.0195	.1292	.3884	.0007	.3468	.4670	.0041
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	0.198 *P*	0.079 *D*	0.123 *D*	5.263 *D*	4.428 *P*	7.927 *D*	3.922 *P*	4.882 *P*	3.311 *P*

Eurodollar Deposits
(London, interbank, bid)
June 16

7-day	9.25
1-month	9.438
3-month	9.625
6-month	9.938

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−0.530
U.S.-Canada Treasury Bills	−0.387
U.S.-Canada Finance Co. Paper	−0.246
Eurodollars-U.K. Local Auth. Deposits	+0.079

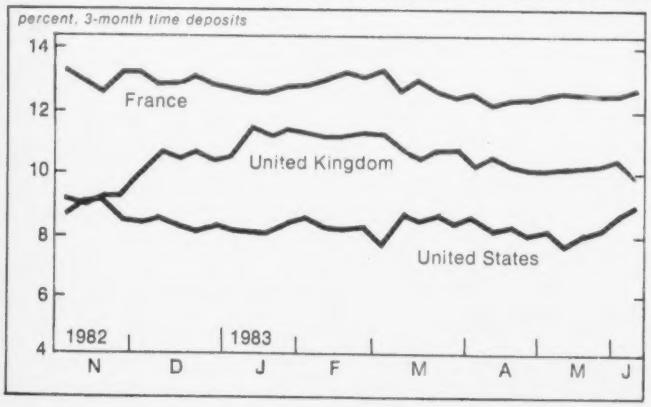
Eurobonds
(average yield on recent straight debt issues)

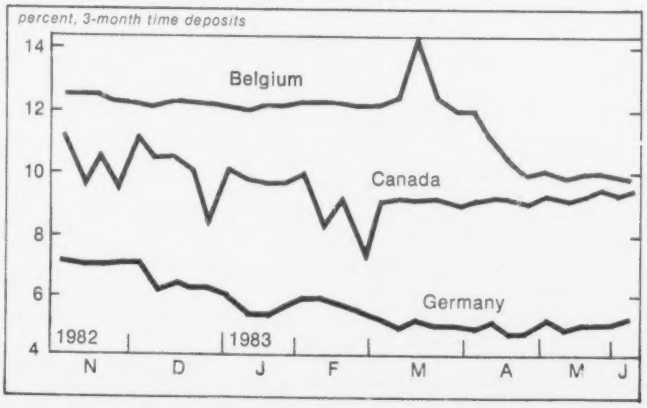
U.S. Dollar Bonds	
7 yrs. and under	11.25
Over 7 yrs.	11.50
DM Bonds	
7 yrs. and under	7.50
Over 7 yrs.	7.75

Gold Price
London afternoon fixing
408.25
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short Term Rate (prime rate), while including customary commissions, reflect neither other fees nor varying compensating balance requirements.

Interest-rate movements in selected industrial countries





Smaller Surpluses, but No Deficits, for Kuwait

Soft world oil markets and the resulting sharp drop in oil revenues have greatly reduced Kuwait's budget and current-account surpluses during the last three years. But thanks to ample income from the government's foreign investments neither will move into deficit.

The draft budget for fiscal 1983-84, which begins July 1, was announced in late April. Contrary to the government's forecasts, however, it is not likely to show a deficit. The budget is designed to offset both the adverse effects on private-sector activity of last year's stock-market crisis and the slowdown in state outlays prescribed by fiscal 1982-83's "austerity budget." Expenditures are projected to rise 12% over the current budget to 3.55 billion Kuwaiti dinars (KD). Although new charges will be levied on some public services and subsidies cut on others, the authorities have apparently decided not to introduce income taxes. And with continued weakness expected in the world oil markets, state revenues are expected to fall to KD3.04 billion—a 5% decline from the level projected for fiscal 1982-83. According to the government's estimates, this would push the budget into the red by some KD517 million ($1.8 billion), not counting the standard allocations to Kuwait's Reserve Fund for Future Generations and to the Kuwait Fund for Arab Economic Development.

The government's projections of state revenues are based primarily on its forecast of Kuwaiti oil production, since the petroleum sector has generated the bulk of government receipts for more than a decade (64% in fiscal 1981-82). Crude-oil production in 1982 averaged 828,000 barrels per day (including its share of Neutral Zone output)—a 27% drop from its 1981 level and less than half the quantity produced in 1980. At its March meeting, OPEC assigned Kuwait a production ceiling of 1.05 million b/d. But given the outlook for world demand for OPEC oil, the country's oil output in 1983—which in the first quarter averaged 878,000 b/d—is expected to fall short of that quota.

As far as the oil-sector forecast goes, the draft budget's estimates of government revenues appear to be realistic. The problem with the budget lies in its estimates of investment income. Official forecasts have consistently understated non-oil revenues, primarily income from government holdings of real and financial foreign assets. If the government again earns as much as KD1.4 billion from its investments, the realized 1983-84 budget will show a *surplus* of about KD800 million—assuming that actual government outlays approximate the level projected.

Historically, Kuwait's actual government expenditures have tended to fall short of budget projections, except in fiscal 1981-82 when outlays slightly exceeded the estimates. However, there are reasons to think expenditures in fiscal year 1983-84—as well as those in the current fiscal 1982-83—will match levels projected by the government.

For one thing, Kuwait's oil output declines have not only severely cut back oil revenues, they have raised other costs as well. With the drop in oil production, associated flows of natural gas liquids—used to fuel electric-power and desalination plants—have fallen, forcing stepped-up usage of more expensive gas oil. It may well be that extra outlays on domestic fuel requirements will offset the government's traditional tendency to underspend.

In addition, the government is likely to be more liberal with its spending as part of its efforts to offset the impact on the private sector of the turmoil in the Souk al-Manakh stock market. Measures taken by the government during the last several months appear to have successfully contained this crisis.

In the absence of any further sharp drop in OPEC's official price for oil, the other main impact on Kuwait of the soft oil market conditions, which are likely to persist over the near term, will be a continued contraction in its current-account surpluses from just under $6 billion this year to slightly over $4.5 billion in 1985. However, Kuwait's current account would have moved into deficit beginning in 1982 had it not been for the government's investment income.

Foreign investments intact

Additions to Kuwait's stock of foreign assets, through at least 1985, will be substantially smaller than they have been in the past, since it seems likely that the authorities will be forced to make use of some foreign investment income to cover a portion of budget outlays over the next two to three years. It is unlikely, however, that the stock of foreign assets will need to be drawn down. Public-sector assets, held mainly by the government, totaled some $72 billion as of the end of 1982. And because the bulk of these are invested internationally, in both financial and real holdings that are providing a still-sizable and diversified income stream, the state of Kuwait remains quite strong financially. Moreover, the country can be expected to continue to register annual financial surpluses, especially after 1985. At that time, demand for OPEC oil is expected to pickup somewhat, a larger proportion of the country's oil exports will be in the form of refined products shipped on Kuwaiti carriers, and state expenditures are projected to level off as major projects are completed. *Sharif Ghalib*

Spain Moving to Curb Deficits, Inflation

Despite initial uncertainties about the direction of Spain's economic policy under the Socialists, the government's actions during almost seven months in office speak louder than its pre-election rhetoric. Although 1982 ended another year of lackluster growth, bringing strong pressures for reflation, the new government thus far has avoided expansionary policies and appears to be focusing on curbing inflation and getting fiscal deficits and external indebtedness under control before tackling the unemployment problem.

The proposed budget for 1983, which was presented to the Cortes in April, calls for a central-government deficit of 1.1 trillion pesetas. While this is up from 1982's deficit of 996 billion pesetas, it is significantly lower than the 1.35-trillion-peseta shortfall forecast for 1983 earlier in the year, and if achieved, it would hold the deficit at 5% of GDP. The budget plan includes a rise in the overall tax burden of about 1%, with the maximum rate of income tax raised to 45% from 43%. Ministerial spending and the social-security budget have been cut back, although investment spending is budgeted to rise by 10% in real terms in order to stimulate productive employment.

The budget proposal for 1983 stops short of the financial stabilization program Spain needs. However, it does provide a basis for hope that the problem of fiscal deterioration is finally being addressed. Because final approval of the budget will probably be delayed until late July, spending in the first half of the year has already been somewhat restricted. Nonetheless, a budget overrun is still a strong possibility, and a large volume of non-budgetary public-sector obligations remains to be financed.

The government's monetary actions over the past several months suggest that monetary policy has been aimed at stabilization. The economic program outlined by the Socialists prior to the election specifically stated that strict adherence to money-growth targets would not be a principal strategy. However, recent developments indicate an extremely restrictive monetary stance. In December, the year-on-year growth rate for M3 was 16.1%. Given that the government has called for 2% real GDP growth in 1983 and a reduction in the inflation rate to 12%, the announced target for M3 of 13% must be considered ambitious and restrictive. Nevertheless, the authorities seem to be making a concerted effort to achieve it. At the end of last year, banks' reserve requirements were raised to 6.75% from 5.75%, and in April, compulsory deposits at the Bank of Spain were increased by one percentage point. By April, year-on-year M3 growth was down to 14.5%, and over the last two months interbank interest rates have exceeded 20%.

Despite such monetary restrictiveness, however, the government's inflation target looks optimistic. Spain's inflation problem has proved to be intractable. The average inflation rate for last year was 14.4%—the same as in 1981 and only a marginal improvement over 1979's 15.7%. Unfortunately, last December's 8% devaluation of the peseta has made the inflation battle all the more difficult. Although prior to the election, the Socialists had viewed the currency move as a means to improve Spain's export competitiveness, there are doubts whether the action was necessary. Spain's export performance in 1982 proved surprisingly strong, indicating that its exports were competitive even before the devaluation. Furthermore, unless wage pressures can be controlled, any short-term benefits from the devaluation will soon be dissipated.

The government's labor policies and recent labor-market developments, however, are likely to have hampered any wage downtrend. The government did fulfill its campaign promise to reduce the work week to 40 hours from 42 hours and increased the statutory minimum vacation to 30 days per year. In addition, the national minimum wage was raised by 13% in January. In the same month, the trade unions and the employers' federation reached agreement on a band of 9.5% to 12.5% for salary increases during 1983. All of these developments can be expected to increase real wage costs this year but, unfortunately, will do nothing to alleviate Spain's continuing rise in unemployment. As of May, joblessness had risen to 2.13 million, 16.3% of the active population.

Prospects for recovery

The Spanish government apparently has realistically accepted that this year will bring only a weak recovery. The budget offers only modest stimulation, and the tight monetary policy will constrain any rebound. The external sector can be expected to provide only a small boost, in that the impact of the global recovery is likely to be meager in 1983. The economy of France —Spain's major market--is contracting, and exports to the OPEC countries, which were an important source of growth in 1982, are unlikely to be sustained. However, as long as wages remain in check, the depreciated peseta should ensure that Spanish exports and tourist facilities are highly competitive. Meanwhile, the fall in the price of oil will save Spain more than $1.5 billion and help to improve industrial profitability, although the weakened peseta will limit these gains.

On balance, the government's forecast of 2% real growth looks somewhat optimistic, but its projection of a narrowing of the current-account deficit to $2.5 billion appears realistic. Expectations of better economic performance in 1984-85 seem justified, although the recovery may not be strong enough to have much impact on Spain's growing pool of unemployed.

Peter A. Davies
Chase London

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CHASE

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U.S. Monetary Policy: Too Loose or Too Tight?

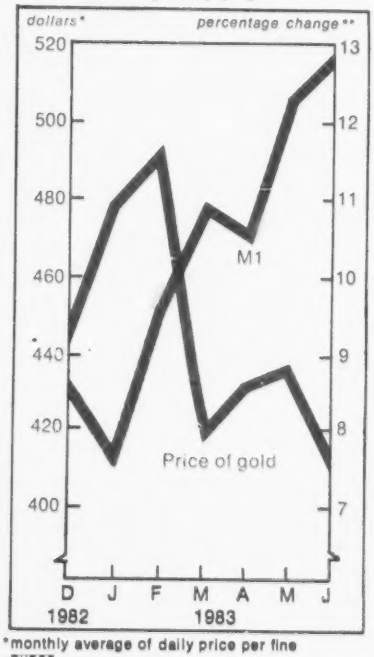
The difficulties of managing U.S. monetary policy have been intensified by conflicting indicators of the current thrust of policy actions and by conflicting approaches being used to interpret these indicators. From the traditional perspective that treats the United States as a "closed" economy—largely insulated from economic trends abroad—U.S. monetary policy is clearly too loose. But from an opposite perspective that regards the U.S. economy as "open"—unable to insulate itself from foreign influences—policy is too tight. The question of which perspective to employ is critical. An erroneous interpretation of the signals by the Federal Reserve in one direction could lead it to take actions that would reaccelerate inflation. And an error in the other direction could induce a move that would jeopardize the fragile economic recovery and the stability of the international financial system.

Economists who employ the closed-economy perspective point out that the narrowly defined money supply, M1, has grown at a double-digit pace over the past 12 months—far above its target range. They argue that the money stock cannot continue to expand at this rate for much longer without igniting another inflationary explosion. The open-economy school notes, however, that international price indicators suggest that U.S. monetary policy is relatively tight. The dollar is strong against all major currencies, while the prices of precious metals remain relatively low.

This conflict between domestic and international indicators of U.S. monetary policy is a recent development. During the fixed-exchange-rate period of the 1950s and 1960s, the signals emitted at home and abroad were generally consistent. And even after the advent of floating exchange rates in the 1970s, indicators used by "closed-economy" and "open-economy" Fed-watchers ordinarily moved together. Rapid money growth was usually accompanied by a weakening dollar and rising prices of precious metals. But today—at least on a week-to-week basis—above-target money growth typically leads to a strengthening, not a weakening, of the dollar, as the market reacts in anticipation of a tightening move by the Fed.

Clearly, if the international "price" indicators are right about U.S. monetary policy, then the domestic "quantity" signals are wrong—and vice versa. Since it is not possible to know which are correct, the important issue for policy is precisely that the indicators *are* yielding mixed signals. The Fed must therefore tread adroitly along a narrow path to avoid plunging off either side of the cliff.

Precious metals prices and the growth of the U.S. money supply



*monthly average of daily price per fine ounce
**year over year

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Thatcher victory fails to resolve Britain's economic policy dilemmas.

At first glance, the recent statistics on the British economy and the huge majority won in last month's election suggest Mrs. Thatcher's government is in an exceptionally strong position. Banks' base rates have been cut by 50 basis points, the inflation rate has dropped to a year-on-year 3.7%, and domestic production is at last responding to the recent large increases in demand. However, the government still faces serious problems in both the short and the long run. The money supply has been growing at an annualized rate of some 16% since February —compared with a target maximum of 11%—and the budget deficit is running at higher-than-expected levels. The bond market is now looking for a rise in interest rates. Without one, the government will be forced to monetize more of its deficit and further swell the money supply; with one, however, the government risks choking off the long-awaited recovery. Furthermore, forecasts currently circulating within the Treasury indicate that, despite Mrs. Thatcher's efforts, public-sector costs will continue to go up over the next few years. Unless the economy grows relatively quickly and so boosts the government's tax base, tax rates will have to be hiked to avoid a widening of the deficit. This would move the government further away from one of its crucial long-term objectives.

Weak export demand causing German recovery to lose steam.

The latest data on the German economy suggest that the recovery, which set in during first months of 1983, is faltering. Industrial production remained provisionally unchanged in May from April's downward revised figure. This level is some 0.5% higher than in January and February. But a similar two-month comparison for industrial-order volume shows a 0.5% decline. Weakness was concentrated in the export sector: Foreign-order volume dropped 2.5% while domestic orders advanced 1%. The outlook for exports for the remainder of 1983 is relatively gloomy. France—Germany's largest trading partner—is taking steps to reduce demand, and Italy remains in recession. Meanwhile Eastern Europe, OPEC, and the non-oil LDC's are not likely to raise their orders for German exports. Domestic demand in Germany, however, should continue to strengthen —albeit at a slower pace than early in the year—as the construction industry remains robust and as consumers' incomes rise again toward year-end. Nonetheless, the recovery overall is expected to be quite weak relative to past recoveries.

Greek economic indicators suggest drachma still overvalued.

The Greek economy remains in a difficult position. Industrial production in the first quarter showed a 2.5% drop from its year-earlier level and shows no signs of picking up. But the balance of payments is deteriorating. Provisional data for the first five months of 1983 show a current-account deficit of $1.08 billion, compared with a $938-million shortfall in the year-earlier period. While the trade deficit declined—both exports and imports fell—the surplus on invisible items such as tourism, shipping, and workers' remittances declined even more. Meanwhile inflation remains high, showing a year-on-year advance of over 22% in May. These figures suggest that, despite the devaluation in early 1983, the drachma remains overvalued against European trading partners. This position can only be remedied by either a further downward adjustment of the drachma or a reduction in inflation relative to that prevailing in the rest of Europe.

Australian budget prospects brighter.

One of Australian Prime Minister Hawke's principal policy objectives—to lower the projected government budget deficit for fiscal 1983-84—is getting a boost from an improvement in the outlook for economic growth. In hopes that a smaller deficit would help engineer a permanent reduction in interest rates, the new Hawke government, at its economic summit in April, set a goal to slash the deficit to A$8.5 billion from the A$9.6 billion projected by the outgoing Prime Minister Fraser. The Fraser projection was based on a conservative expected real growth estimate of only 1.5% for Australia's non-farm sector. Real growth prospects now, however, look much better—at least 2.5% seems likely. Consequently, the deficit will shrink without any government actions to cut spending or increase taxes. At present, the initial Hawke target looks easy to attain. And Mr. Hawke might be tempted to try for an even lower deficit.

Venezuelan current-account deficit may narrow despite likely fall in oil revenues.

Although Venezuela's average export volume for petroleum is running at about its 1982 rate, lower prices this year will mean a substantial drop in total oil earnings. In the first five months of this year, oil-export volume has been averaging 1.5 million barrels per day (mbd), with the average price slightly below $25 per barrel. For all of 1982, the average export price was about $27.50 per barrel, with an average export volume of 1.56 mbd. The expectation is that, for the year as a whole, 1983 export prices will average around $24.50 and volume will trend out at a little under 1.5 mbd. As a result, oil revenues are expected to drop to about $13.2 billion this year from $15.6 billion in 1982. This shortfall in export earnings, however, is likely to be more than offset by a large policy-imposed cut in imports. Consequently, the overall current-account position could show a deficit smaller than last year's $3.5 billion.

Jamaica posts still-sluggish growth and a current-account deficit.

The Jamaican economy remains in a somewhat precarious position. The government budget deficit has risen to the equivalent of 16% of GDP and the money supply (M2)—fueled by domestic credit expansion to the public sector—has been growing at a rate of about 26% for the past year. Despite the expansive thrust of demand-management policies, however, real GDP is estimated to have posted a mere 2% gain in fiscal 1982-83, only modestly more than the previous year's 1.2% rise. Furthermore, performance in the different sectors of the economy has varied widely. Inflation, meanwhile, increased slightly to just under 7%, as imports continued to provide a vent for excess aggregate demand, at least until January when a dual exchange-rate system was enacted. However, Jamaica's overall balance of payments underwent a substantial deterioration, swinging into a $146-million deficit from a $43-million surplus in fiscal 1981-82.

Japanese government looking for ways to reverse import decline.

Japan's continued weak domestic demand and the resultant higher-than-expected current-account surplus are causing government concern over a possible resurgence of trade frictions. The first quarter's 0.8% increase in GNP (seasonally adjusted, annual rate) was primarily the result of stepped-up government consumption spending and a sharp drop in imports. Private-sector domestic demand actually fell, with declines in housing and plant-and-equipment investment as well as a steep rundown of inventories. With imports consequently depressed, the seasonally-adjusted current-account surplus topped $8.1 billion in the first five months of 1983, already surpassing the $6.9 billion surplus recorded for all of 1982. The fear that trade tensions will be reignited has created pressure for steps to boost domestic demand and imports. But the Bank of Japan remains adamantly opposed to any cut in domestic interest rates before the yen advances on the foreign-exchange markets. In addition, because of Japan's continued budget deficit problem, any fiscal stimulus, even an income tax cut, will be difficult. Pressed nonetheless to take some action, the government is reportedly studying new incentives and additional regulatory changes to bolster imports.

Madagascar grapples with external debt difficulties.

Madagascar continues to face severe balance-of-payments problems. Further arrears have been accumulated on its over $1.5-billion debt, despite reschedulings and other international aid. A one-year, $55-million IMF standby agreement went into effect in early July 1982. The government succeeded in meeting conditions of the agreement until last month, when its final drawing was cancelled because of arrears that resulted from a shortfall in export receipts. Cloves—Madagascar's second largest foreign-exchange earner—normally bring in 25% of export receipts, primarily from Indonesia. However, during price renegotiations between the two countries, the clove trade ceased. Exports reportedly have now resumed, and the IMF is discussing terms for a new standby agreement. The country rescheduled its foreign commercial-bank debt through the London Club in January and its foreign official debt through the Paris Club in April. Drawings on a $54-million structural-adjustment loan, which the World Bank agreed to in May, are now awaiting the bank's appraisal of economic conditions.

The Consumer Finally Comes on Strong

Despite a slow start, consumers now seem quite willing to lead the economy into a boom. Although retail sales increased only 0.7% in June, the three previous months showed gains that averaged over 2%. This strength—along with a faster pace of housing construction—is more than offsetting continuing weaknesses in other sectors. Although the recent rise in interest rates and the possibility of further increases are causing some concern about the strength and sustainability of the recovery, consumer spending is likely to be robust enough to keep the economy expanding for a while.

Even with the spring spurt in sales, personal consumption expenditures are still lagging behind the pace of the two previous recoveries. Retail sales, adjusted for inflation, have increased just under 5% since the recession's trough in November, compared with gains of 7% and 6%, respectively, in the first seven months following the 1969-70 and 1973-75 recessions.

One reason consumers got off to a slower start this time around was the unusually sharp inventory liquidation over the winter. With inventory financing costs remaining high, businesses were content to meet the stepped-up demand initially by reducing stocks, which kept a damper on production and employment, and hence on income. Eventually inventories got so low, however, that increases in demand in the past few months have been filled by expanding production, which has added a further boost to employment and income. In fact, production gains have outpaced sales, and as a result, inventories have actually been rising recently.

Retail sales have also received a lift from consumers' greater willingness to borrow as the employment picture has brightened. In the last six months, consumer credit outstanding grew at an 8% annual rate, while income rose only 6%. In the previous six-month period, income advanced almost as rapidly, but credit use grew by less than 3%.

The third installment of personal income-tax reductions, which took place on July 1, is another force lending at least moderate support to the consumer expansion. After-tax income in July will jump by nearly 2%—double recent monthly increases. Usually, such a robust gain would be expected to lead to sharp sales increases in subsequent months. But the spring spending spree may somewhat moderate further gains as consumers rebuild their savings a bit, especially with interest rates edging upward.

On balance, however, the odds are that this process—higher sales followed by higher production, employment, and income—will become self-sustaining. In other words, this expansion should prove to be a normal recovery. It would take quite a shock—more than seems probable in the near term—to change this outlook.

Douglas L. Bendt

The High Cost of Restraining M1

Federal Reserve officials continue to insist that the behavior of M1 is of limited concern in monetary policy decisions. And over the past several months, it has become increasingly evident that the Fed has been more concerned with stabilizing interest rates than with containing the growth of the money supply. The consensus among most economists and money-market analysts, however, is that the Fed will soon have to take steps to rein in M1 growth—still far above target for the year—in order to head off a rekindling of inflation expectations. But when Fed officials do begin to move in this direction—assuming they have not already done so—they are likely to find that, because of institutional changes in the last few years, it will take a much sharper rise in interest rates than previous experience would suggest to get M1 growth back into the desired range.

In past years, the Fed could rely on a relatively small rise in interest rates to effect a reduction in the growth of M1. A hike in rates would curb the demand for credit and money: Borrowing would diminish, and with the increasing opportunity cost of keeping balances in non-interest bearing demand deposits, funds would be shifted into less-liquid, interest-bearing instruments not included in M1.

Recent institutional changes, however, have made M1 less responsive to movements in interest rates. The introduction of Super-NOW accounts early this year and the inclusion of these accounts in the Fed's definition of M1, have altered the way in which individuals are likely to react to a rise in rates. An increase in rates is now more likely than before to elicit an intra-M1 shift in individual portfolios. As a consequence, the Fed will find that, compared with its experience before these changes came about, a much larger rise in interest rates will be required to achieve a particular deceleration of M1 growth.

Credit demand, however, is still likely to be sensitive to a rate increase. And a substantial rise in interest rates could have a strong negative effect on real economic activity.

The Fed's focus on interest rates has, in any event, reduced uncertainty over the future course of money-market interest rates. One clear piece of evidence of this is the drop-off in interest-rate hedging activity. Contract volume in Treasury-bill futures has fallen to about one-half of the peak volume reached in mid-1982, reflecting the market's judgment that the Fed would allow rates to fluctuate only over a narrow range.

Interest-rate targeting, however, does not mean that the targets will not change. And if the Fed wants to avoid a resurgence of inflation expectations—and another painful episode of bringing them under control—it may soon be forced to allow rates to rise significantly in order to subdue the rapid growth of the money stock.

Dan C. Roberts

Africa and Middle East Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1981		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
		6 months ending	change from year earlier	in billions of dollars	$ per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	12-month changes: latest data	12-month changes: consumer prices	latest data	money supply(M1)	exchange rate in U.S. dollars July 13, 1983	change from year earlier	current monetary conditions	
Africa																			
Algeria	Government reportedly has decided to double capacity of gas pipeline to Italy.	Dec. '81	−14%	36.0*	1,935	May	1,649	−45%	0.7	0	Oil output avgd. 651,000 b/d Jan.-April, almost same as year earlier.	Dec. '81	+ 7%	Sept.	+24%	.2116	− 7%	Sonatrach Euroloan for $700 million signed June 3.	Algeria
Angola	Military and agricultural expenditures and export decline have caused short-term debt build-up.	Dec.	− 7%	n.a.	n.a.	Dec.	122	+ 6%	1.0	0	Oil export prices no longer pegged to OPEC, discounts offered.	Dec.	+15%	n.a.	n.a.	.0330	0	Inflation continues to increase yearly, now reaching 15%.	Angola
Egypt	World Bank to lend $400 million in fiscal 1983-84 for development projects.	Jan.	+15%	30.8	710	Mar.	751	− 2%	0.7	53	Crude-oil prices raised by 25¢-50¢ per barrel starting July 1.	Jan.	+15%	Mar.	+27%	1.2092	+ 1%	Central bank foreign-exchange reserves holding steady.	Egypt
Kenya	Good crop outlook and rising commodity prices should improve GDP and export earnings.	Nov.	−14%	6.6	383	May	325	+95%	2.8	391	Trade balance has improved; IMF and official aid promised.	Feb.	+14%	Mar.	+11%	.0800	−27%	International reserves have doubled since autumn 1982.	Kenya
Malawi	Smallholder crops expected to increase in volume.	Dec.	− 4%	1.4**	219	May	30	−36%	1.1	100	Larger tobacco and tea output should improve trade balance.	Feb.	+20%	Apr.	+ 6%	.8949	− 1%	Gov. borrowing from banking system to fund deficits.	Malawi
Morocco	Grain crop estimated down 30% to 3.2 million tons owing to poor rainfall.	Feb.	−13%	15.2	735	Apr.	67	−87%	0.2	922	Income from tourism rose 16% last year to $380 million.	Feb.	+ 4%	Nov.	+14%	.1460	−23%	Islamic Development Bank lends $20 million.	Morocco
Niger	Uranium output projected to drop 14% in 1983 in response to world oversupply.	Dec. '81	−10%	1.6	281	Mar.	22	−75%	0.4	0	Government austerity budget implemented preceding IMF aid negotiations.	Mar.	− 3%	Dec.	− 5%	.00262	−21%	Foreign-exchange reserves down to one-tenth 1981 holdings.	Niger
Nigeria	Oil production exceeding OPEC daily quota by 400,000 b/d, offsetting low early-1983 levels.	Apr.	−27%	70.8	888	May	1,218	0	0.7	0	Debt rescheduling and IMF aid under negotiation.	Sept.	+ 4%	Dec.	+ 5%	1.4751	0	Exchange-rate adjustments likely after August elections.	Nigeria
Senegal	Good weather suggests quadrupling of groundnut harvest over 1980-81 low of 192,000 tons.	Dec. '81	−19%	2.5	439	Mar.	4	−33%	0.1	174	Groundnut harvest boosting export revenues; imports being held down.	Feb.	+ 9%	Jan.	+14%	.00262	−10%	Inflation rate has slowed to 9% from 1982's 16%.	Senegal
South Africa	Gold prices and severe drought should cause real GDP to decline 2% in 1983.	Apr.	+ 8%	70.2**	2,330	May	436	−13%	0.4	857	Imports projected to fall 13% below 1982 owing to reduced economic activity.	Apr.	+13%	Mar.	+13%	.9125	+ 5%	Foreign-exchange controls being relaxed gradually.	South Africa
Sudan	Government expenditure emphasizing completion or rehabilitation of existing projects.	Dec.	+14%	6.7	356	May	16	−25%	0.1	586	Exports reduced by partial loss of Saudi import subsidies.	Mar. '82	+15%	Feb.	+44%	.7600	−32%	Government deficit up 30%, financed by external borrowing.	Sudan
Tunisia	Poor rainfall cuts 1983 cereal production to 900,000 tons, versus 1982's 1.3 million tons.	Mar.	−26%	8.1	1,240	May	390	−22%	1.3	0	First quarter 1983 trade deficit was $420 mn., up from $250mn. year earlier.	Mar.	+11%	Mar.	+18%	1.4925	−19%	France to provide $65 million in aid this year.	Tunisia
Zimbabwe	World Bank to lend $26.4mn. for highway construction and $7.3mn. IDA credit for forestation.	Dec.	+ 1%	4.4	586	Mar.	130	0	1.1	154	Austerity required to meet conditions of $324-million IMF standby credit.	Dec.	+12%	Dec.	+32%	1.0126	−26%	Overall government expenditure cut by $206 million.	Zimbabwe
Middle East																			
Kuwait	Government outlay on development projects holding steady.	Apr.	− 3%	24.3	17,350	May	4,728†	+13%	6.7	0	Domestic oil output avgd. 741,000 tons Jan.-April, up 16% from year earlier.	Dec.	+ 9%	Mar.	−18%	3.4129	− 2%	Govt. reportedly bought 10% shareholding in Volkswagon.	Kuwait
Oman	Seven-year, $300-million Euroloan for development projects signed on June 6.	Apr.	− 1%	4.8*	5,372	Apr.	1,132†	+ 5%	16.8	0	Petroleum Development Oman made two new discoveries of light oil.	n. a.	n. a.	Oct.	+16%	2.8935	0	Oman Housing Bank raising $43.4-million Euroloan.	Oman
Qatar	State's oil company to develop north gas field with two foreign partners; $5 billion initial cost.	Apr.	−26%	6.0	24,000	Dec.	387†	+ 6%	2.3	0	Jan.-April oil output averaged 222,000 b/d down 32% from same 1982 period.	n. a.	n. a.	Dec.	+12%	.2747	0	Claims on private sector rising steadily.	Qatar
Saudi Arabia	New contract awards drop sharply during 1983 first half.	Apr.	−46%	155.8	16,719	May	28,834†	−11%	2.9	0	Trade surplus for 1982 put at $38.2 bn., down from 1981's $83 bn.	Dec.	+ 1%	Sept.	+19%	.2900	− 1%	Three industrial companies borrow $188.5 million locally.	Saudi Arabia
United Arab Emirates	Central bank puts 1982 federal deficit at $873 million, 40% greater than had been projected.	Apr.	−20%	29.8	29,780	Oct.	3,111†	− 2%	0	0	Abu Dhabi oil output avgd. 725,000 b/d in Jan.-April, down 24% from year ago.	n. a.	n. a.	Feb.	+ 6%	.2727	0	Gas liquefaction company to raise $500-million Euroloan.	United Arab Emirates

*1980 **1982 †Excluding state reserves

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World Interest Rates

market rates as of July 13, 1983; bond yields as of July 8, 1983

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	8.50	9.51	n. a. intervention rate	9.00	9.50	4.00	17.00 penalty rate 20.00	4.50	4.00	5.50
Day-to-Day Money	9.125 July 14	9.25	8.875	6.80	12.188	5.10	17.854	5.25	4.00 1-month Euro-Swiss fr. rate	6.313
Treasury Bills 91-day, Middle Rates	9.05	9.23	9.375	9.25	n. a.	n. a.	16.451 170 days	no dealing	no market	5.375
Commercial Paper prime, 3-month, asked	9.375 finance paper discount basis	9.35 finance paper 15% tax w/h	9.143	8.90 Certified	12.625 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	9.55	9.30 15% tax w/h	9.438	8.90 Certified	not traded	5.00	18.55	no market	5.00	no market
Government Bonds Long-term, new and old issues, average yield	11.52	12.25	n. a.	9.84	13.46	8.30	18.55	8.84	4.52	7.11
Industrial Bonds prime, long-term, new and old issues, average yield	12.25 Aa Industrials	13.125	n. a.	11.19	14.82	8.25	17.62	8.93	5.85	6.53
Bank Short-Term Rate (prime rate)	10.50	11.00	9.50	13.25	14.55	8.00	18.75 ⅛ qtrly fee on outstdng.	7.00	7.50	6.00
Bank Time Deposits 3-month	9.375 Cert. of Dep.	9.40	9.875	8.90	12.625	5.35	11.50	5.75 large deposits	4.00 residents only	3.75 20% tax w/h
Eurocurrencies 3-month, asked	10.312	9.688	10.00	no market	14.124	5.313	no market	5.75	4.938	6.563
Exchange Rates—in U.S.$ rates floating against the $	—	.8119	1.529	.0193	.1284	.3862	.0007	.3452	.4714	.0042
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	0.640 *P*	0.418 *P*	1.390 *P*	4.05 *D*	5.282 *P*	7.351 *D*	4.635 *P*	5.600 *P*	3.753 *P*

Eurodollar Deposits
(London, interbank, bid)
July 14

7-day	9.500
1-month	9.688
3-month	10.063
6-month	10.438

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−0.614
U.S.-Canada Treasury Bills	−0.489
U.S.-Canada Finance Co. Paper	−0.487
Eurodollars-U.K. Local Auth. Deposits	+0.082

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.625
Over 7 yrs.	11.75
DM Bonds	
7 yrs. and under	7.75
Over 7 yrs.	7.75

Gold Price
London afternoon fixing
427.25
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short Term Rate (prime rate), while including customary commissions, reflect neither other fees nor varying compensating balance requirements.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	(May) 3.5	(May) 5.1	(May) 3.7	(Jun.) 8.9	(Jun.) 2.4	(Jun.) 16.0	(Jun.) 2.8	(May) 2.9
Industrial production*	(May) 3.7	(Mar.) 2.6	(May) 2.3	(Apr.) −0.8	(May) −3.7	(May) −7.6	(Dec.) −8.5	(May) 2.3
Trade balance† *(billions of local currency units)*	(May) −$6.91	(May) C$1.63	(May) −£0.55	(May) −FF7.66	(May) DM3.62	(May) −Lit.410	(Jun.) −SF0.68	(May) ¥645.79
Money supply (M1)*	(Apr.) 10.5	(May) 7.9	(Apr.) 14.0	(Feb.) 9.9	(Apr.) 11.3	(Dec.) 16.4	(Mar.) 13.9	(Mar.) 5.3
Velocity of money (M1)*	(Mar.) −4.4	(Dec.) 0.4	(Dec.) −1.9**	(Sept.) 0.6**	(Dec.) −3.7	(Dec.) −1.8**	(Dec.) −5.2**	(Dec.) 0.8
Reserves minus gold *($ million, change from previous month)*	(May) −242	(May) −163	(May) 177	(May) 239	(May) −532	(May) 561	(May) 341	(May) 332

* Percent change from 12 months earlier. ** based on GDP † Figures are only for the month indicated.

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Indonesia Acts to Offset Lower Oil Revenues

Indonesian authorities wasted little time in acting to offset the effects of OPEC's oil-price cut in March. The decision to lower official crude-oil prices by $5 per barrel worsened the prospects for Indonesia's balance of payments and threatened a sharp reduction in budget revenues. More fundamentally, however, the oil-price drop raised questions about the viability of the country's long-term economic development strategy. The government under President Suharto responded rigorously, adopting measures designed not only to cope with the immediate balance-of-payment and budget problems, but also to lead to a more balanced economy in the long-run.

The most urgent problem facing Indonesia as a result of the OPEC price move was how to arrest the deterioration in its balance of payments. Over the last two years the country's external position has been steadily weakening, primarily because of declines in net earnings from oil. By fiscal 1982-83, which ended March 31, net oil and gas revenues had fallen to $7.2 billion from a peak of $10.6 billion in fiscal 1980-81. This stemmed mainly from declining oil-export volume in an over-supplied market as Indonesia held closely to OPEC prices over most of the period. Stepped-up production of liquefied natural gas brought increased earnings which partially offset the lower oil revenues. However, in the same two years, earnings from other exports dropped by some 30% to $3.9 billion, reflecting chiefly the world recession in commodity prices, but also the government's progressive ban on log exports. Exports of plywood—which had been intended to compensate for the restriction on log shipments—lagged, largely because of the depressed housing market in the United States. At the same time, imports were rapidly rising. The oil-price increases of 1979-80 had boosted Indonesian incomes, and capital goods had begun to arrive for the development projects spurred by the oil boom.

As a consequence, Indonesia's current-account balance shifted from a $2.1 billion surplus in fiscal 1980-81 to a deficit of $6.8 billion in 1982-83. This shortfall —about 7.5% of GDP—was financed partly by drawing on international reserves. By the end of the last fiscal year, as OPEC prices dropped, net reserves had shrunk to $6.4 billion. The OPEC price decline posed the possibility that fiscal 1983-84 would see a still larger deficit. Since each $1 drop in the price of crude oil subtracts around $300 million from net oil and gas earnings, a current-account deficit of at least $8 billion was not an unrealistic forecast. And with imports still rising, the government feared that the figure might rise as high as $10 billion.

The OPEC price decline also promised a reduction in government budget revenue. In recent years, the oil and gas sector has supplied 65%-70% of total revenues. During the boom years of 1978-81, revenues rose faster than expenditures, and some 4.5 trillion rupiah accumulated in government accounts. By fiscal 1982-83 the situation had reversed, and these accounts were being draw down, despite a virtual freeze on government salaries and severe cutbacks in the subsidies on food, fertilizer, and oil products. The proposed budget for fiscal 1983-84 was brought in balance by again severely limiting expenditures—but under the assumption that OPEC's official benchmark price would remain unchanged at $34. The price reduction OPEC subsequently agreed to would have thrown the budget into deficit by more than 1 trillion rupiah. And while this could presumably have been financed by drawing on accumulated cash reserves, the government sought ways to restore the balance.

Beyond these immediate concerns stood the larger issue of Indonesia's development program. During the late 1970s the government had moved by steps toward a strategy based on heavy industry. Capital-intensive projects underway or in planning by 1982 in steel, oil refining, petrochemicals, non-ferrous metals, and electric power generation, together with an array of supporting infrastructure, totalled over $30 billion. The surge of oil revenue in the late 1970s made it possible to push that program forward and at the same time to devote enough resources to other objectives in order to increase rice production to near self-sufficiency, to raise standards of living throughout the country, and to provide jobs for most new entrants to the labor force. Declining oil revenues confronted government planners with hard choices and forced the sacrifice of some objectives.

Hard decisions and sacrifices

The Indonesian government reacted promptly and decisively to these problems. On March 30, it devalued the rupiah by 27.5%, to a rate of 970 per U.S. dollar. The new value restored the international competitiveness of the rupiah (as measured by the real effective exchange rate) to approximately its level of November 1978, after the last major devaluation. The 1978 devaluation was followed by a brisk—though brief—revival of non-oil exports, but an upswing of inflation quickly eroded its effect. Circumstances now, however, are different, and it seems likely that the inflationary consequences of the devaluation itself can be contained. The growth of credit has been kept within tight limits, and price reaction in April and May was less than expected. On the other hand, markets for Indonesian exports are weak; neither exports nor imports may be quick to respond. The short-term effect of the devaluation on the balance of payments

Indonesia Acts to Offset Lower Oil Revenues *(continued from page 7)*

is therefore problematic. Nonetheless, two other purposes should be served by the action: First, devaluation was meant to restore confidence and eliminate speculation against the rupiah so as to bring about a return of short-term capital. Second, it was intended to increase government rupiah revenues from oil and gas exports by an amount sufficient to offset the effect of the OPEC price decline. Success on both of these counts seems assured. However, because the effect of devaluation on the balance of payments is uncertain and probably not large in the short run, it was necessary that other measures be taken as well. The government realized this and within a few weeks enacted cutbacks in the country's development program.

The decision to pare capital projects was by all accounts a hard one for the government. First, it meant that the pace of economic growth, which had already slowed in fiscal 1982-83 to about 3%, would remain below previous expectations for some time. Second, it was difficult to determine priorities. Each major project had its own rationale—generally in terms of balance-of-payments earnings or savings—and many projects had already obtained foreign financing.

Despite the hard choices, the government enacted strong measures, affecting some 50 projects with a total cost in excess of $20 billion. The exact impact of these actions on the balance of payments in fiscal 1983-84 cannot easily be determined. In many cases, where the project was only in the design or engineering phases, the savings to be realized will be chiefly from later years. The Indonesian government has estimated that the devaluation and project cutbacks combined will bring the fiscal 1983-84 current-account deficit down to $6.5 billion. This level should be manageable with little or no additional drawdown of reserves, if the expected reflow of capital takes place. Already, in the first two months after devaluation, reserves bounced back to about $7.2 billion, so this expectation seems warranted.

In addition, funding from multilateral sources and foreign-aid donors was assured at the recent Inter-Governmental Group on Indonesia meeting in the Netherlands. And financing from commercial sources is already well along thanks to the completion of a $1-billion syndicated loan.

The remaining funding should not prove difficult to obtain. If necessary, Indonesia could call on the IMF. The country's credit balance with the Fund is currently very small and its quota of SDR 720 million would permit substantial borrowing. Around $600 million could be obtained without conditions, much more on a conditional basis.

The measures that have been taken thus far seem to have brought short-term problems under control. They should also help to make the longer-term issues easier to solve. Indonesia is still a heavily populated country whose labor force grows by nearly 2 million a year and whose food production has barely kept pace with consumption. A decade of rapid growth based on oil earnings made it possible to gain ground on these problems but not to solve them. They would become more difficult if GDP growth remained low for any great length of time. World Bank estimates suggest that growth of around 6% would be needed to absorb the annual increment to the labor force.

Long-run strategy

A strategy to achieve such growth in the 1980s and 1990s depends greatly on how important oil and gas resources continue to be to the Indonesian economy. In its most recent report on the country, the World Bank projects that net oil and gas earnings will revive in the second half of the 1980s and provide substantial support for the economy through the end of the century. This projection relies first on the Indonesian government forecast that oil production capacity can be raised from the present level of about 1.65 million barrels per day (mbd) to 1.9 mbd by 1990, and second, on an assumption that domestic consumption will grow at an average rate of around 4.5%-5% per year, that is, slightly slower than GDP. Given these assumptions and a forecast of a moderate increase in oil prices, real earnings from the oil and gas sector will rise by about 2% per year on average over the rest of the decade. Non-oil export earnings will then have to rise by an estimated 9% per year in real terms to support the desired GDP growth rate of 6%. In other words, there will have to be a shift of emphasis in the economy. The non-oil sectors will have to assume a greater role in supporting the balance of payments, providing employment, and generating savings and investment.

World Bank and Indonesian economists believe this can be done. Industry will need to develop in a more labor-intensive way to provide efficient import-substitution and exports. The plantation sector will have to be modernized and made more productive. Domestic savings will have to be mobilized to provide capital and impediments to private investment reduced.

There are signs that the government has already begun to prepare the way for such a strategy. It has announced that budget savings from project cutbacks will be applied to investment in labor-intensive projects. And in early June, a decision was made to eliminate most of the direct controls on bank credit and interest rates—a move which should help to stimulate private savings and channel them through the banking system. The readiness of the Indonesian government to undertake such measures is the best assurance that longer-term problems will be overcome.

Willard D. Sharpe
Chase Hong Kong

CHASE

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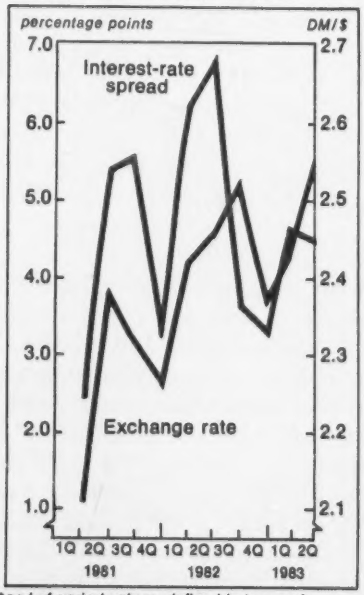
The Dollar: Strong for How Long?

NOTICE TO READERS

This is the final issue of **International Finance.**
Please see note on page 3.

Forecasters who look at "economic fundamentals" are debating the likelihood of a major fall in the dollar's value in the not-too-distant future. Broadly speaking, forecasters relying on fundamental analysis fall into one of two camps: those who project a major selloff of the dollar later this year or early in 1984, and those who argue that the dollar will be relatively strong for some time, although probably somewhat weaker next year than present forward rates suggest. The first group is inclined to stress the effects of the rapidly deteriorating U.S. trade balance. The second group tends to focus on the projected stability of relative monetary policies; these analysts argue that in such circumstances, anticipated interest-rate differentials, adjusted for inflation, will continue to support dollar-denominated assets as long as economic growth in the United States remains strong relative to other key-currency countries.

U.S.-German interest-rate differentials* and the DM-value of the dollar



*end-of-period values, defined in terms of 3-month Eurocurrency deposit rates

The fact that neither group is much inclined to dispute the other's main premise underscores the difficulty of making fundamental exchange-rate theory operational. Both groups adopt an asset-preference approach. But those focusing on the effect of the U.S. trade deficit stress differences in asset preferences between U.S. and foreign residents. Even more important to their analysis is the direct effect of a rapidly widening trade deficit on market perceptions of the relative rates of return on dollar- versus non-dollar-denominated assets. That is, they stress a market perception that the corrective mechanism for a widening international payments deficit is a depreciating dollar. In contrast, those focusing on the stability of monetary policy emphasize the likelihood that expectations regarding inflation-adjusted interest-rate differentials are unlikely to narrow and may tend to widen in an environment in which economic growth in the United States is relatively strong.

Whatever happens, however, neither of these arguments is likely to prove to be a very satisfying explanation of the dollar's movement. It is difficult to see the trade deficit itself becoming a *sufficient* condition for a major episode of dollar weakness. It is also hazardous to project U.S. money growth that continuously threatens the upper bound of the Federal Reserve targets, even if the pace of economic recovery remains strong. But what can easily be agreed is that in circumstances where U.S. interest rates appear likely to fall relative to rates abroad, a large U.S. trade deficit will make for a significantly greater weakening of the dollar than would otherwise have taken place.

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Italian recovery hopes hinge on export turnaround.

As expected, Italy's June election resulted in no significant change in the make-up of parliament, and negotiations on the formation of a coalition government are now under way. The new government will face a difficult economic situation: Real GDP appears to have stabilized in the first quarter of 1983 after three consecutive quarterly declines. Fixed investment declined sharply in the first quarter, and more recent industrial production figures do not yet show clear evidence of any upturn. On a more positive note, monthly inflation rates have fallen, but in June the year-on-year rate stood at a still-high 16%. The trade deficit narrowed to 6.3 trillion lira over January-May, compared with 8.8 trillion in the comparable 1982 period. Nonetheless, the large public-sector deficit and double-digit inflation preclude any domestic stimulation. Consequently, official hopes for the recovery remain pinned to an upturn in exports.

Finland adopting firmer stance on economic policy.

When Finland's central bank raised its discount rate to 9.50% from 8.50% on June 16, it moved against the immediate general trend in the world toward lower rates. However, the previous reduction to 8.50% from 9.25%, made in June 1982, was part of a short-term policy package that led to negative real interest rates. The recent rise merely restores rates closer to their long-term trend. As bank lending has risen by almost 20% since the 1982 reduction in rates, this latest increase was by no means inappropriate even though the trade unions' organization and the Federation of Industries both criticized the action as a move that would increase industry's costs and refuel inflation. Finland's main policy changes, however, are still yet to come. The government's autumn budget is expected to include a small increase in taxation and a limitation on the growth of government expenditures to about 6% per year—a figure that would imply a small decline in real terms.

Colombia in midst of economic slowdown, accelerated peso devaluation.

Colombian economic growth has slowed significantly in the past two years, as a result of debt and foreign-exchange problems in neighboring Venezuela and Ecuador and the drop in its own export earnings as a result of the worldwide recession. The decline in services earnings and the difficulties Colombian industries have faced in competing against imported goods have worsened the slowdown. Growth of real GDP dropped from over 4% in 1980 to 1.4% in 1982 and almost no growth is expected in 1983. Inflation has moderated somewhat during this period of decline, with the rate falling to just over 20% in June 1983 from 24% last December. The pace of devaluation, however, has had to be accelerated to about 25% currently, owing both to the large devaluations in neighboring countries and to the strength of the U.S. dollar. This implies that Colombia is currently devaluing the peso in real terms and offsetting some of the currency's previous overvaluation.

Pakistan's balance of payments shows striking improvement.

Pakistan's balance-of-payments performance improved smartly during fiscal 1982-83, which ended June 30. According to preliminary estimates, exports may have risen as much as 13%. A sharp drop in traditional exports appears to have been more than offset by a sharp jump in non-traditional items arising from the rupee depreciation. Imports declined an estimated 0.7% in value because of additional import-substitution gains, a roughly constant oil-import bill, and minimal private-sector response to further import liberalization. With workers' remittances rebounding an astounding 28%, the current-account deficit narrowed to some $730 million, or 2.5% of GDP, in 1982-83 from a revised $1.61 billion in 1981-82, or 5.2% of GDP. And with net aid disbursements and loan drawdowns from the IMF up sharply, international reserves rose spectacularly to a level equivalent to more than three months of imports. Although a repeat of last year's performance would be difficult, another favorable balance-of-payments outcome appears quite likely in 1983-84—possibly a current-account deficit of under $1 billion and a further addition to international reserves.

Ireland's balance-of-payments prospects looking up.

Irish spirits have been lifted by the announcement of a trade surplus for June—the first surplus since October 1975. This gives some further indication that the tough economic policies introduced in February's budget—and confirmed by the recent tax increases and expenditure cuts—are beginning to pay off. Other signs have shown up in the consumer price index, which posted a 9.8% rise for the year to May, compared with 17.1% and 20.4% in 1982 and 1981, respectively. Moreover, the current wage round suggests that there is some willingness to accept cuts in real wages. Ireland still has a long way to go, however, before it resolves its economic difficulties. Even if the trade account stays in surplus, the interest payments on the country's overseas debts will keep the current account in deficit for at least another year. Moreover, the trade surplus is partly the result of the slowdown in the domestic economy. But if the government is able to keep strict policies in place, there is a good chance that improving world-trade prospects will allow Ireland to expand the domestic economy in 1984 on the back of export-led growth. If all goes well, Ireland could see its current-account balance moving into surplus by the end of next year.

Algeria insulates economy from weak oil and gas demand.

Algeria has had reasonable success in cushioning itself from the weak conditions in the oil and gas market. In 1982, hydrocarbon revenues fell by only 10% to $12.8 billion. This was achieved because over 35% of oil production was exported as refined products. Despite a 19% decline in exports of crude, refined exports increased by 97% to 17.7 million tons. In addition, following the successful conclusion of gas contracts with French, Belgian, and U.S. companies, LNG exports grew by 41.5% to 16.7 billion cubic meters. This also resulted in a 54% rise in condensate exports to 12.4 million tons. These developments, together with a generally conservative import policy, ensured that the deterioration in Algeria's balance of payments in 1982 was limited. It is estimated that the current-account balance thus moved from a small surplus of $85 million in 1981 to a modest deficit of about $1 billion last year. With further gas export contracts being finalized and condensate production rising, it initially appeared that Algeria's hydrocarbon revenues would rise in 1983. However, given the fall in oil prices—and the consequent decline of index-linked gas prices—as well as the recent desire by gas customers to reduce purchases, it now seems likely that 1983 hydrocarbon export revenues will remain at about $13 billion.

With this issue, *International Finance* is ceasing publication after more than 17 years of reporting and analyzing developments in the world economy. The editors wish to express their thanks to the current contributors and support staff, who include: Carlotta A. Austin, Mark Babunovic, Douglas L. Bendt, Elizabeth Brennan, Angela Yvette Coe, Peter A. Davies, Richard W. Everett, A. Blake Friscia, Sharif Ghalib, Miguel Gomez, Robert F. Graboyes, Donald W. Green, Ronald A. Krieger, Melanie L. Lau, Thomas A. Lawler, Ronald G. Layard-Liesching, Benny P. Mah, George de Nemeskeri-Kiss, Nina Ramondelli, Dan C. Roberts, J. Nicholas Robinson, Vincent G. Salvo, Willard D. Sharpe, Susan Shawkat, Robert S. Slighton, Robert S. Smith, Lee R. Thomas, Laura K. Wallace, Terry S. Wiginton, D. Sykes Wilford, Gwendolyn Wright, and Sandra C. Zimmer, and to the hundreds of others who have helped to write, edit, and otherwise support the production of *International Finance* over the years. A special thanks goes to Robert F. Nestman of the printing firm of Guide-Kalkhoff-Burr for the skillful, creative, and dedicated supervision of all aspects of the production of every issue of *International Finance* since its inception in 1966.

The Chase Economics Group will continue to analyze international economic issues from time to time in *The Chase Economic Observer*, a bimonthly publication concerned primarily with trends and developments in the U.S. economy. Subscribers to *International Finance* who do not now receive the *Economic Observer* can be put on the mailing list by sending their address label to: Economic Publications, The Chase Manhattan Bank, 1 Chase Manhattan Plaza—28th floor, New York, N.Y. 10081, U.S.A.

Diana J. Rich
Managing Editor

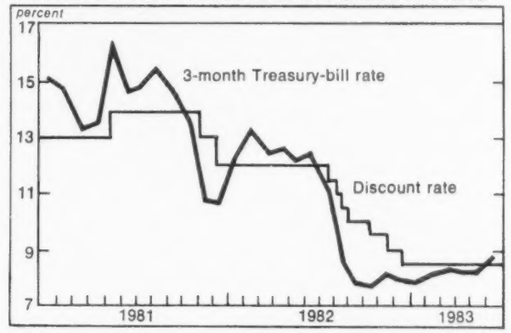
Does the Discount Rate Matter?

The Federal Reserve's announcement last month of new M1 growth targets helped to ease immediate pressures on the monetary authorities to raise interest rates in order to curtail money growth. Nonetheless, an increase in the discount rate sometime over the next few months may still be in the cards.

Fed-watchers disagree over exactly what role the discount rate plays in monetary policy. Some analysts argue that discount-rate changes signal the future direction of Fed policy. Others contend that the discount rate (which the Fed charges commercial banks on borrowed reserves) has no real policy role but merely is changed in reaction to the movement of other interest rates. In fact, there is evidence to support both points of view: Even though the discount rate does follow the movement of other rates, it is also true that a change in the rate provides information about future Fed policy.

Economists who assert that the discount rate has no influence as a policy instrument often point out that the Fed sometimes goes for long periods of time without changing the rate, and even then, the changes tend to follow rather than precede movements in market interest rates. The chart (right), which tracks changes in the discount rate against rates on three-month Treasury bills, appears to support the argument that adjustments in the discount rate are made in reaction to market conditions—not the other way around.

Market interest rates and the discount rate



The opposite position—that the Fed does use the discount rate as a policy tool—holds that by changing the rate, monetary policymakers send a signal to the market about whether they intend to pursue a tighter or more-relaxed policy. If the discount rate is raised, the market should expect that the Fed wishes interest rates to stay at a higher level; if it is lowered, an easier stance can be expected. Unless both the direction and the timing of the discount-rate change are accurately and fully anticipated by market participants, the action provides new information that will have a definite effect on market interest rates and ultimately on real economic activity.

The table (right) compares the closing rates on Treasury bills and certificates of deposit the day before and the day after a change in the discount rate. It is particularly noteworthy that in almost every case the discount rate *led* a change in the other two rates in the same direction. This suggests that adjustments in the discount rate do have a noticeable impact on market rates.

Disconcertingly, the evidence in the chart and the table, taken together, seems to suggest that the discount rate both leads and lags other interest rates. However, this is not a contradiction. In contrast to its use of open-market operations—which allow the Fed to move readily into and out of the market on a daily basis—the Fed is often more hesitant to make an adjustment in the discount rate. And because of this, the discount rate will generally follow market rates up or down. But because of this reluctance to move the discount rate frequently, any adjustment provides information about where the Fed believes interest rates *should* be. Thus, a change in the discount rate provides additional information to the market about possible future Fed actions.

Despite a substantial backup in market rates, the Fed has not changed the discount rate since last December from its current level of 8.5%. This may be because it expects interest rates to ease somewhat over the next few months. However, if the Fed does finally raise the discount rate, the action will send an unambiguous message to the market that monetary policymakers feel rates should stay at a higher level.

Dan C. Roberts

Effects of discount-rate changes on other interest rates
(percent)

Discount rate change	Treasury bills		Certificates of deposit	
	Day before	Day after	Day before	Day after
(5/5/81) 13.00→14.00	16.01	16.52	17.55	18.29
(11/2/81) 14.00→13.00	12.75	12.30	14.89	14.24
(12/4/81) 13.00→12.00	10.52	10.22	12.00	11.43
(7/20/82) 12.00→11.50	11.06	10.75	13.28	12.55
(8/2/82) 11.50→11.00	10.17	9.80	11.92	11.28
(8/16/82) 11.00→10.50	9.25	8.05	11.20	10.16
(8/27/82) 10.50→10.00	7.14	8.16	9.72	10.27
(10/12/82) 10.00→9.50	7.75	7.42	9.98	9.29
(11/22/82) 9.50→9.00	8.10	7.95	9.03	8.74
(12/14/82) 9.00→8.50	8.00	7.63	8.90	8.65

Europe, Canada & U.S. Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	INDUSTRIAL OUTPUT		GNP IN 1982		BALANCE OF PAYMENTS					MONEY AND BANKING							COUNTRIES
											12-month changes							
		latest data	12-month change	In billions of dollars	real growth	latest data	reserves (less gold) in $ million	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	latest data	consumer prices	latest data	money supply (M1)	central bank rate△ July 27, 1983	exchange rate in U.S. dollars July 27, 1983	current monetary conditions	
Austria	Real GDP now forecast to grow by 1% this year and 1.5% in 1984.	Mar.	— 5%	66.6	+1.1%	May	4,948	+ 6%	3.1	0	Current acct. surplus Jan.-May 5.6 bn. schilling vs. 700 mn. deficit year-earlier.	May	+ 2%	Apr.	+11%	3.75%	.0542	Interest rates remain steady.	Austria
Belgium	Manufacturing output shows signs of picking up as export prospects improve.	Apr.	— 5%	57.5	—1.9%	May	5,036	+51%	1.1	0	Trade deficit shrinking in wake of improvements in export competitiveness.	May	+ 8%	Dec.	+ 4%	9.00%	.0191	Interest rates easing.	Belgium
Britain	Retail sales up 6% from year earlier and some 2% GDP growth is expected for 1983.	May	+ 2%	505.8*	—2.0%	May	11,886	—12%	1.5	0	June current account was in deficit; year to date shows only a £33 mn. surplus.	June	+ 4%	May	+15%	9.375%	1.5225	Rates cut after election but upward pressures remain.	Britain
Denmark	Activity picking up; real GDP growth of 1.5% expected this year.	Apr.	+ 5%	54.5	+3.1%	May	3,345	+66%	2.4	0	Jan.-April trade deficit down to kr 1.1 bn., vs. kr 2.7 bn. year earlier.	May	+ 8%	Dec.	+13%	7.50%	.1059	Interest rates stable, but money supply now accelerating.	Denmark
Finland	Real growth of 2% still expected for 1983 after last year's 1% figure.	Mar.	0	47.8	+0.9%	May	1,001	—22%	0.9	0	Jan.-May showed 583 mn. markka trade surplus, vs. 1.2 bn. year earlier.	May	+ 8%	Mar.	+19%	9.50%	.1779	Central-bank discount rate raised to 9.5% in June.	Finland
France	Industrial production up in April and May; leading indicators down sharply; recession expected shortly.	May	+ 1%	568.5	+0.3%	May	18,701	+19%	1.9	0	Trade deficit on declining trend; exchange controls eased slightly.	May	+ 9%	Mar.	+11%	9.50%	.1270	Franc holds steady in EMS.	France
Germany	Activity levels off after strong first quarter; foreign orders remain extremely weak.	May	— 4%	659.7	—1.1%	May	45,004	+ 6%	3.5	0	Current account in surplus despite unfavorable trade-volume movements.	May	+ 3%	May	+10%	4.00%	.3817	Interest rates hold steady.	Germany
Ireland	Restrictive policies will hold 1983 GDP growth down to 0.5%	Dec.	— 4%	16.2*	+1.1%	May	1,884	—31%	2.5	0	June trade surplus narrows first half year deficit to 394 million pounds.	Feb.	+12%	Feb.	+ 5%	15.00%	1.2100	Rates have eased along with stronger position in EMS.	Ireland
Italy	Christian Democrats suffered setback in June election; parliament little changed; deficit still rising.	May	— 8%	345.6	—0.3%	May	16,612	+28%	2.3	0	Trade deficit declining as terms of trade improve.	June	+16%	Nov.	+18%	17.00%	.00064	Interest rates hold steady.	Italy
Netherlands	Industrial output recovers slowly; June inflation down to 2.5% year-on-year rate.	May	+ 2%	136.9	—1.7%	May	10,779	+23%	2.0	0	Mfgd. goods trade balance improving, reflects improved competitive position.	June	+ 4%	Mar.	+13%	4.50%	.3407	Interest rates ease as guilder strengthens in EMS.	Netherlands
Norway	GDP looks set for a small decline in 1983 after last year's 0.6% fall.	Apr.	0	55.6*	+0.8%	May	7,272	0	6.1	0	Officials forecast current-account deficit in 1983, but surplus widely expected.	May	+ 9%	Jan.	+ 7%	8.00%	.1336	Discount rate cut to 8% from 9% in June.	Norway
Portugal	New government launches austerity package.	Oct.	+ 1%	23.5**	+5.5%	Apr.	501	+44%	0.7	0	First-quarter current-account deficit $670 mn. against year earlier $1.09 bn.	Apr.	+21%	Dec.	+16%	23.00%	.0083	April consumer price inflation was year-on-year 20.8%.	Portugal
Spain	World recession and drought continue to inhibit recovery.	Dec.	— 1%	183.7*	+0.3%	Apr.	6,040	—35%	2.3	0	Jan.-May current-account deficit $2.69 billion, up from $2.47 billion in 1982.	June	+11%	Dec.	+11%	8.00%	.0067	Monetary policy tight; interbank rates over 25%.	Spain
Sweden	Export bouyancy contributing to the 1.7% growth expected this year.	Mar.	0	97.7	—0.1%	May	3,516	+ 3%	1.6	0	First half 1983 shows kr 8.6 billion trade surplus, vs. kr 2.9 billion year ago.	June	+ 9%	Dec.	+10%	8.50%	.1296	Rates steady since April's discount-rate cut.	Sweden
Switzerland	First quarter fall in GDP confirms fears of no economic growth this year.	Dec.	— 8%	101.5	—1.7%	May	12,667	— 3%	5.1	0	Trade balance improving, but first half-year deficit was still SF 4.5 billion.	June	+ 3%	Apr.	+10%	4.00%	.4760	Interest rates down as franc appreciates against DM.	Switzerland
Turkey	Output appears to be rising briskly; elections scheduled for November.	n. a.	n.a.	54.3	+4.4%	May	1,158	— 9%	1.4	1,657	Current-account deficit widened in first quarter as export-growth fell.	Mar.	+25%	Dec.	+40%	31.50%	.0047	Interest rates reduced but remain high in real terms.	Turkey
Canada	Economic recovery is now well under way.	May	+ 1%	282.9	—4.8%	May	3,471	+68%	0.7	0	Strong current-account surplus trend faltered in the first quarter of 1983.	June	+ 6%	May	+ 8%	9.50%	.8116	Policy constrained by monetary conditions in the U.S.	Canada
United States	Recovery gathers speed; consumer spending booms.	June	+ 5%	3,059.3	—1.7%	May	22,799	+15%	1.1	0	Trade balance moves further into deficit as oil imports rise.	June	+ 3%	June	+13%	8.50%	—	New monetary targets lessen chances of Fed's firming.	United States

*1981 **1980 △most recently reported

World Interest Rates

market rates as of July 27, 1983; bond yields as of July 22, 1983

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	8.50	9.51	9.375 intervention rate	9.00	9.50	4.00	17.00 penalty rate 20.00	4.50	4.00	5.50
Day-to-Day Money	9.375 July 28	10.25	9.125	7.35	12.125	5.00	17.854	5.25	7.125 1-month Euro-Swiss fr. rate	6.50
Treasury Bills 91-day, Middle Rates	9.07	9.26	9.313	9.25	n. a.	n. a.	16.315 92 days	no dealing	no market	5.375
Commercial Paper prime, 3-month, asked	9.375 finance paper discount basis	9.35 finance paper 15% tax w/h	9.091	8.90 Certified	12.50 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	9.40	9.30 15% tax w/h	9.406	8.90 Certified	not traded	5.00	18.55	no market	5.125	no market
Government Bonds Long-term, new and old issues, average yield	11.81	11.75	n. a.	9.86	13.19	8.25	18.37	8.71	4.53	7.092
Industrial Bonds prime, long-term, new and old issues, average yield	12.55 Aa Industrials	13.00	n. a.	11.56	14.85	8.25	17.79	8.98	5.84	6.27
Bank Short-Term Rate (prime rate)	10.50	11.00	9.50	12.50	14.55	8.00	18.75 ⅛ qtrly fee on outstdng.	7.00	7.50	6.00
Bank Time Deposits 3-month	9.125 Cert. of Dep.	9.47	9.813	8.80	12.25	5.35	11.50	5.75 large deposits	4.00 residents only	3.75 20% tax w/h
Eurocurrencies 3-month, asked	10.188	9.625	9.938	no market	13.688	5.188	no market	5.75	5.063	6.625
Exchange Rates—in U.S.$ rates floating against the $	—	.8115	1.529	.0191	.1269	.3813	.0006	.3411	.4733	.0042
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	0.641 *P*	0.392 *P*	1.300 *P*	3.467 *D*	5.245 *P*	6.18 *D*	4.573 *P*	5.324 *P*	3.565 *D*

Eurodollar Deposits
(London, interbank, bid)
July 27

7-day	9.563
1-month	9.688
3-month	10.00
6-month	10.438

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−0.507
U.S.-Canada Treasury Bills	−0.498
U.S.-Canada Finance Co. Paper	−0.488
Eurodollars-U.K. Local Auth. Deposits	−0.079

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.75
Over 7 yrs.	12.00
DM Bonds	
7 yrs. and under	7.75
Over 7 yrs.	8.00

Gold Price
London afternoon fixing
426.25
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate (prime rate), while including customary commissions, reflect neither other fees nor varying compensating balance requirements.

OPEC's investable surplus and the U.S. share

(billions of dollars[1])

	1978	1979	1980	1981	1982
Accumulated OPEC current-account surplus since 1974	160.0	214.0	321.0	373.0	365.0
Plus: Value of pre-1974 net foreign assets	17.0	16.0	16.0	15.5	15.0
Equals: Total net foreign assets	177.0	230.0	337.0	388.5	380.0
Plus: Net borrowing less lag in receipt of oil revenues	22.0	23.0	31.0	40.0	52.0
***Equals:* Investable cash surplus**	**199.0**	**253.0**	**368.0**	**428.5**	**432.0**
Identified U.S. share[2]:					
Deposits in U.S. banks and other portfolio investments	35.2	43.6	56.7	69.8	81.1
Plus: Other U.S. placements	6.2	4.9	5.9	9.3	11.4
Identified direct investment	0.38	0.66	0.57	3.53	4.36
Plus: Deposits at major foreign branches of U.S. banks	21.2	29.2	30.0	27.3	20.8
Equals: Total U.S. share	62.6	77.7	92.6	106.4	113.3
U.S. share as a percentage of OPEC's total investable surplus	**31.5%**	**30.7%**	**25.2%**	**24.8%**	**26.2%**

[1]at year-end. [2]Includes the relatively small investments of Bahrain and Oman, which are not members of OPEC.

Data: U.S. Department of the Treasury, Federal Reserve, U.S. Department of Commerce, and Chase estimates of investable surplus

OPEC Adjusts to a Current-Account Deficit

With the sharp drop in demand for their oil since 1980, OPEC members have seen a striking turnaround in their combined balance-of-payments position. After registering sizable annual surpluses through 1981, the OPEC current-account balance last year swung into deficit by an estimated $8 billion, after official transfers (see table below). Currently, the aggregate deficit is expected to more than quadruple in 1983. And given the small likelihood of any major pickup in demand for OPEC oil over the next few years, these nations as a group seem destined to remain in the red at least through 1985. It is now clear that many OPEC nations have begun to draw down some of the foreign assets amassed since 1974 to help finance these deficits. And others are now using their investment income to cover current budget needs instead of reinvesting it.

OPEC current-account balance
(billions of dollars)

	1981[1]	1982[1]	1983[2]	1984[2]
Merchandise exports	**267**	**205**	**172**	**202**
Gross oil earnings[3]	251	188	153	180
Non-oil exports[4]	16	17	19	22
Merchandise imports[5]	**−151**	**−149**	**−141**	**−152**
Service exports	**47**	**45**	**42**	**42**
Investment income	35	31	27	25
Service imports	**− 92**	**− 89**	**− 87**	**− 93**
Transfers	**− 19**	**− 20**	**− 19**	**− 19**
Official	− 8	− 8	− 7	− 6
Current-account balance	**52**	**− 8**	**− 33**	**− 20**

[1]estimated. [2]projection assuming oil prices hold at current levels. [3]excluding gas. [4]including re-exports. [5]f.o.b.
Data: Chase Economics Group

The marked current-account reversal occurred despite significant retrenchments in the public spending programs of the OPEC nations that either noticeably slowed import growth or—in the case of Nigeria, Libya, and Iran—led to an actual import decline. OPEC's total outlays for imports of goods and services (and transfer payments) in 1982 fell by about $4 billion to $258 billion. This was, however, more than offset by a $64 billion drop in export earnings to $250 billion, resulting primarily from a 25% decline in oil revenues. OPEC oil production fell 18.6% last year to 18.4 million barrels per day (mbd), and the effective average price dropped 4.4% to about $32.75 per barrel.

The continued soft demand for OPEC oil forced the cartel to reduce its "base" price by $5 per barrel and to impose a production ceiling of 17.5 mbd on its members at a specially called meeting last March. OPEC's combined output has remained below that level. And oil ministers, at their regularly scheduled meeting in Helsinki last month, left the production ceiling unchanged. The aggregate current-account deficit is now projected to widen dramatically to around $33 billion in 1983. Moreover, for the first time since 1974, even the four Arabian Peninsula nations—Saudi Arabia, Kuwait, the United Arab Emirates (UAE), and Qatar, which over 1974-82 generated over 80% of the cumulative OPEC surplus—will register a combined *deficit* of some $10 billion (see table below).

This expected further deterioration in the overall OPEC balance will occur despite additional budget adjustments by the members nations this year— particularly in Indonesia, Venezuela, Nigeria, and Iraq. Even the Peninsula states have been forced to cut back. OPEC's total current-account outlays are expected to fall by about 4% to $247 billion. Nonetheless, the projected decline in overall export earnings will again be much larger—down 14% to $214 billion—owing partly to a continued drop in income from foreign assets but mainly because gross oil earnings are projected to shrink further this year to about $153 billion (based on assumptions that OPEC's 1983 crude-oil output will average just over 17 mbd and that prices will remain at current levels, yielding an average effective oil price of about $29 per barrel).

Demand for OPEC oil is expected to rise in 1984. But, given that virtually all members of the cartel are currently producing at well-below desired levels, the most OPEC can hope for is that prices will fall no further. *If* oil prices hold, *if* OPEC output averages as much as 20-21 mbd, and *if* payments for imported goods and services, adjusted for inflation, can be held roughly constant next year, then OPEC's overall deficit will contract in 1984. It will, however, remain significantly large—probably $15-20 billion.

OPEC current-account balance: Regional breakdown
(billions of dollars)

	1980[1]	1981[1]	1982[1]	1983[2]
Peninsula states[3]	71.9	71.1	19.5	−10.0
Rest of Middle East and North Africa[4]	24.4	−17.0	−11.4	− 9.0
Other OPEC nations	10.6	− 2.6	−15.7	−14.0
Aggregate balance	**106.9**	**51.5**	**− 7.6**	**−33.0**

[1]estimated. [2]projection assuming oil prices hold at current levels. [3]Saudi Arabia, Kuwait, United Arab Emirates, and Qatar. [4]Iraq, Iran, Algeria, and Libya.
Data: Chase Economics Group

The shift in the overall current-account balance is already having an impact on the international deployment of OPEC's huge surplus. The table on page 6 shows how the growth of OPEC's gross foreign assets last year slowed considerably, compared with the rapid build up over 1978-81, as a result of the turnaround in the aggregate current account. Gross foreign assets—that is, the cash surpluses accumulated

OPEC Adjusts to a Current-Account Deficit *(continued from page 7)*

by OPEC's public and private sectors and available for international investment or other types of foreign placements—totaled approximately $432 billion at the end of 1982. Government holdings accounted for about three-fourths of this total, and just over 80% of that represented the public assets accumulated by the four Peninsula states: Saudi Arabia, $145-150 billion; Kuwait, $72-75 billion; the UAE, $28-32 billion; and Qatar, $12-14 billion. These official assets include loans, but not outright grants, made to *non-OPEC* countries. The table calculates OPEC's accumulated investable cash surplus since the early 1970s and shows the known placements of OPEC funds in the United States and in major foreign branches of U.S. banks in recent years.

A further breakdown of the international disposition of OPEC's aggregate financial surplus during 1974-82, based on available data from various official sources, is given in the table below. These data indicate that the OPEC surplus actually *identified* as invested or loaned abroad (plus approximately $3.1 billion placed in the United States before 1974) totaled the equivalent of $376 billion—substantially smaller than the end-1982 estimate of OPEC's accumulated foreign assets on page 6 of $432 billion.

The $56 billion discrepancy is partly explained by estimation errors. However, the difference is primarily attributable to investments and other placements by the oil exporters *not* captured in the official statistics. These include: (a) unrecorded purchases of gold by both the private and public sectors, (b) trade credits given in exchange for oil exports, (c) OPEC deposits—especially by the private sector—in Swiss fiduciary (trustee) accounts, (d) sizable "loans" made by the Peninsula states to Iraq since 1980, (e) unrecorded joint-venture and other direct investment in some non-oil developing countries and in other OPEC nations, and (f) last—but not least—*unidentified* financial and direct investment in the industrialized nations. In the United Kingdom, for example, the available data provide little information on OPEC investments outside of bank deposits and government securities. Moreover, some of the oil exporters' investments in the United States are not reflected in the official statistics because they are undertaken by third parties.

Changing patterns of disposition

Two aspects of how the deployment of OPEC funds has changed since 1979 are especially noteworthy. First, the proportion of new assets held in the form of bank deposits—particularly with U.S. banks—has declined sharply: from $40 billion or 66% of the identified surplus in 1979 to a drawdown of $16.5 billion in 1982. (Preliminary data indicate that there was a further drawdown of nearly $8 billion in the first quarter of 1983.) This trend reflected both the growing preference for long-term investments (particularly in their U.S. portfolios) of the Peninsula states—which had already built-up strong liquidity positions—and the reserve drawdowns by the other members of OPEC to finance widening current-account deficits.

The second noteworthy aspect about what OPEC has been doing with its surplus is the marked increase in the U.S. share of non-bank placements by the OPEC nations—from $2 billion or 10% of new investments identified in 1979 to $9 billion or 44% last year. This reflects a renewed preference—mainly by the Peninsula states—for U.S. investment, which has been spurred in recent years by the strengthening of the dollar, higher real interest rates in the United States relative to Europe and Japan, the breadth and depth of the U.S. capital markets, and the expected relative strength of the U.S. economy over the long run.

Sharif Ghalib

Disposition of OPEC's identified financial surplus
(billions of dollars)

	1974	1979	1980	1981	1982	Total 1974-82
Identified financial surplus	**56.0**	**60.9**	**86.6**	**49.7**	**3.9**	**372.9**
Deposits in banks	28.7	40.0	41.2	1.2	−16.5	132.4
United States (domestic)[1]	4.2	5.1	− 1.2	− 1.9	4.4	14.3
United Kingdom (sterling)	1.7	1.4	1.4	0.4	1.3	5.5
Eurocurrency and other	22.8	33.5	41.0	2.7	−22.2	112.6
U.S. bank foreign branches	n. a.	8.1	0.8	− 2.8	− 6.4	20.8
Other investments	**27.3**	**20.9**	**45.4**	**48.5**	**20.4**	**240.5**
United States (domestic)[1]	7.3	2.0	15.4	18.4	9.0	75.1
Portfolio[2]	6.6	3.3	14.4	15.0	6.9	63.7
Other[3]	0.7	− 1.3	1.0	3.4	2.1	11.4
United Kingdom	5.5	1.0	1.4	1.1	− 1.1	8.6
Other industrial countries	11.0[4]	8.7	17.0	19.4	6.6	137.9
Loans to LDCs		− 9.6	6.7	7.2	3.9	
International organizations and gold	3.5	− 0.4	4.9	2.4	2.0	18.8

[1]Includes investments by Bahrain and Oman. [2]Includes U.S. Treasury bills and bonds, federal agency bonds, corporate bonds, and stocks. [3]Includes direct U.S. investment, prepayment for U.S. military exports, and non-bank liabilities. [4]In 1974, loans to LDCs were not reported separately.
Data: Bank of England, U.S. Department of the Treasury, Federal Reserve, and U.S. Department of Commerce